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Annex to

Economic Intelligence Weekly

France: Short-Term Trends and Prospects

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FRANCE: FAVORABLE SHORT-TERM PROSPECTS

The French anticipate near-normal economic growth this year despite the marked downturns foreshadowed for most other developed countries. While this expectation clearly is optimistic, circumstances do favor a better economic performance for France than for most other industrial countries.

Because of preferential status with the Arab oil states, France has suffered little loss in oil deliveries and is unlikely to have energy supply problems this year. The economy is better insulated than most in Europe from recessions in other countries, because foreign trade contributes less to GNP. Internally, both consumption and investment demand remain buoyant. Industrial growth probably will continue at a rapid pace during the first half of 1974 and ease later when demand is expected to flag.

The French expectation of achieving a 4% rise in real GNP may be difficult to realize, for several reasons. Demand in countries that bulk large in French trade -- notably West Germany, Italy, and Belgium – will likely be too weak to allow export volume to expand by the expected 8%. Sales of civilian goods and armaments to oil-exporting countries almost certainly will offset much less of the $5 billion increase in the oil import bill than Paris is counting on. Finally, growth could be hurt if the government focuses too long on the inflation problem. Measures needed to compensate for weakness in aggregate demand may be too timid or too late, notwithstanding the government's commitment to rapid economic growth.

Recent Developments

The cyclical downturn in French economic growth took hold during the latter part of 1973. From July to November, industrial production rose at an annual rate of only 2% compared with 11% in the booming first half. Petroleum supplies were generally adequate during the fourth quarter, despite the Arab supply cutbacks. The main problem was a lack of unused plant capacity, as an official survey of enterprises confirmed in November. At the same time, consumer demand remained strong. The value of retail sales (seasonally adjusted) jumped by 7% from July to October.

Inflation persisted as France's most worrisome economic problem. The rise in consumer prices accelerated to an 11% annual rate during the fourth quarter, and wholesale prices rose even more sharply as the costs of imported raw materials surged. Wages remained an important inflationary factor, rising at an estimated annual rate of 17% during the fourth quarter. Higher oil prices alone accounted for about half of the 0.6% rise in consumer prices in December.

The Pompidou government has followed an anti-inflationary policy throughout the past 18 months, relying mainly on monetary measures. Growth of the money supply, on a seasonally adjusted basis, was held to an annual rate of only 2% from August through November. In early December – several weeks before the huge rise in oil prices – controls on monetary expansion were tightened another notch. Interest rates have shot upward, with the call money rate reaching 14% late in January, compared with 11% in October and 7% a year ago. Fiscal policy remained neutral during the last months of 1973 as the government kept the budget in balance. The tightening late in the year of the loose system of price controls is unlikely to help much in stemming the tide of inflation.

France's trade account stayed in the black during the second half despite deteriorating terms of trade. A surplus of $1.4 billion in 1973 – the largest ever -- permitted the government to promote France's economic role abroad by encouraging long-term capital outflows. Nevertheless, West Germany's booming trade balance, huge reserves, and slower inflation led during the summer to a weakening of the franc relative to the mark. In the early fall a wave of speculation hit the franc, and by November France had lost $2.7 billion -- nearly one-quarter -- of its official reserves. With a substantial trade deficit looming for 1974, in large part because of record oil prices, the franc again came under pressure in January. This time, as reserves started to plunge, Paris took the surprise decision to float the franc.

Prospects for 1974

The 1974 outlook for economic growth is brighter for France than for most of its Common Market partners. The French expect output to rise about 4% in real terms. Even if it falls short of 4%, French economic growth should compare favorably with growth in other large European countries. The outlook in West Germany and Italy is for a gain of 2% at most, and the United Kingdom faces a drop of 2% or more, depending on how soon the labor disputes are settled. Sharply increased labor and raw material costs insure a high inflation rate for France. Moreover, high prices for oil imports and sluggish economic growth elsewhere in Europe will push the trade account into deficit despite the recent floating of the franc. In these respects, France will fare better than the United Kingdom and Italy but not as well as West Germany.

Strong Domestic Demand a Plus This Year

Domestic demand is expected to hold up well at least in the first half of this year. Production at nearly full capacity in the second half of 1973 led to widespread ordering of plant and equipment. Orders already on hand should guarantee heavy investment spending until mid-year. Industrialists surveyed in December forecast a volume of investment 8% higher in 1974 than last year. Consumer demand also should be strong in the coming months, considering the near-record wage increases in 1973 and the large hikes expected in the first quarter of 1974.

Since the onset of the oil crisis, the rate of economic growth estimated for 1974 has been reduced by one and one-half percentage points. The cut reflects the anticipated effects of the soaring cost of oil imports. Because inflation already is severe, Paris probably will not try to offset fully the contractionary impact of the estimated $5 billion increase in the oil import bill. Demand for French goods also will suffer because higher oil prices are expected to slow economic growth and import demand in other developed countries.

Relatively unhampered by oil supply problems, industrial growth is expected to continue near the long-term average of 6.5% during the first half of 1974. The best gains should be recorded by the basic metals, electronics, and machinery industries, all of which entered the year with above-normal backlogs of orders and below-normal stocks. Growth of chemicals production will slow from last year's exceptional pace, in some instances because of shortages of petrochemical feedstocks. Textile production in particular will be hurt by shortages of petroleum-based fibers. Other industries will be hit by reduced demand. The automobile industry, for example, now anticipates no gain in domestic sales and only a small increase in export volume.

Prices and Jobs: No Cause for Cheer

Inflation has now accelerated to an 11% annual rate, and a similar increase is expected for 1974 as a whole. In the first quarter alone, the cost of living will jump by about 4% – largely because of the recent oil price hikes. Rising prices also are in prospect for other raw materials. Even more important, however, is the likelihood of rapidly rising labor costs. Through the first quarter, the annual rate of increase in wages probably will approximate the 16% experienced last year. Even if rapid gains in labor productivity continue, unit labor costs will jump substantially in 1974.

The number of unemployed -- currently about 400,000 on a seasonally adjusted basis, compared with 427,000 in September – could rise to 500,000, or 2.4% of the labor force. Although historically high, this rate probably would not present a major political problem, as the most militant groups of workers would be least affected. Because of a persistent shortage of skilled workers, many people laid off from factory jobs will find employment in other firms. The 1.8 million foreign workers also will cushion the shock. Mostly occupying menial jobs that ordinarily are not attractive to French workers, these workers are vulnerable to displacement if the job situation deteriorates.

Initiatives in the Foreign Sector

The floating of the franc and recent announcement that Paris plans to borrow $1.5 billion abroad to cover some of its increased oil costs underscore French determination to protect foreign reserves. The prospective huge rise in the oil import bill this year threatened a further reduction in reserves unless action were taken. Before the oil crisis, the French government anticipated a $1.5 billion trade surplus in 1974. Now, a deficit of perhaps $3 billion is in view, assuming a 10% cut in petroleum consumption and a 14% rise in export value. Paris already has set a goal of restoring trade equilibrium by the end of 1975 and clearly hopes that increased arms sales to the oil-exporting countries will help it do so.

Barring unusual success in selling arms and fundamental change in its trade balance with developed countries, France faces a current account deficit of roughly $4 billion in 1974. To minimize loss of reserves, the government has already begun reversing its policies on long-term capital, which throughout 1973 aimed at encouraging outflows and discouraging inflows. Restrictions on French borrowing abroad have been eased and controls on capital outflows tightened. To stimulate inflows of short-term capital, the reserve requirement on non-resident bank deposits has been abolished.

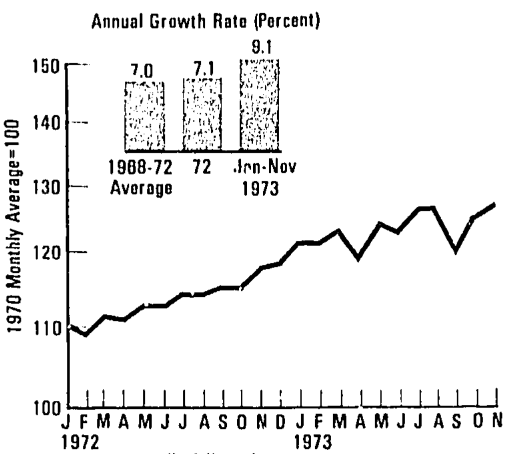
Economic Policy: Ready to Change Course

French policymakers hope that strong consumer and investment demand will keep the economy growing at a moderate pace without government intervention, but they stand ready to reverse course quickly. Paris realizes that, if economic conditions in France's major trading partners deteriorate beyond present expectations, its restrictive measures could provoke a sharp slide at home. Although inflation is a major concern, the government still considers growth its top economic priority. It will seek to avoid a slowdown that would hamper France's drive for economic primacy in Europe and possibly cause widespread labor unrest leading to a political crisis like that of 1968.

After 18 months of progressive tightening of monetary policy, the government apparently intends to maintain credit limits at about the current level. The rate of increase in bank credit is being held below the rate of growth of nominal GNP. If a decision is taken to stimulate the economy, the first action would be to loosen credit restraints. With demand for consumer credit probably remaining strong, additional private spending could be quickly stimulated by making more funds available. The floating of the franc has given Paris added freedom to ease monetary policy without chancing substantial loss of foreign reserves.

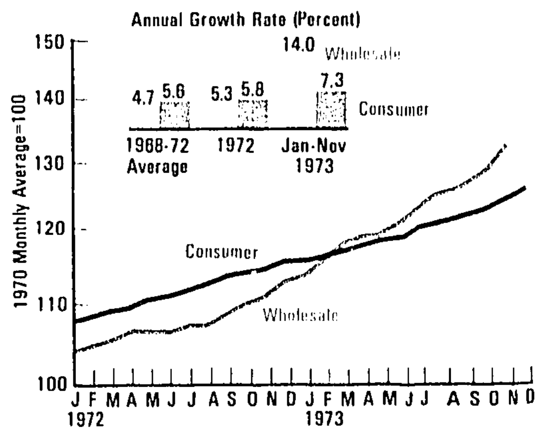
FRANCE: DOMESTIC ECONOMIC INDICATORS

INDUSTRIAL PRODUCTION*

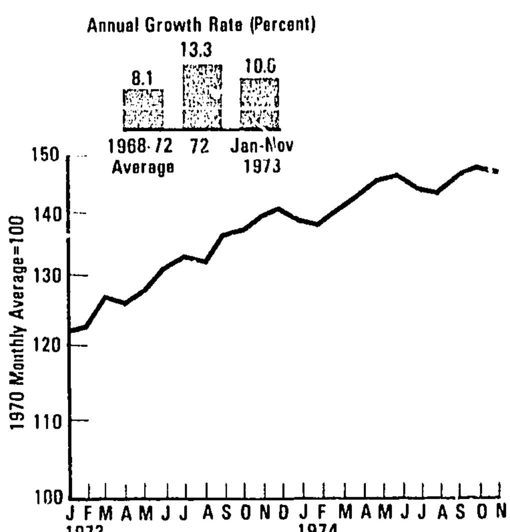


*Seasonally Adjusted

PRICES



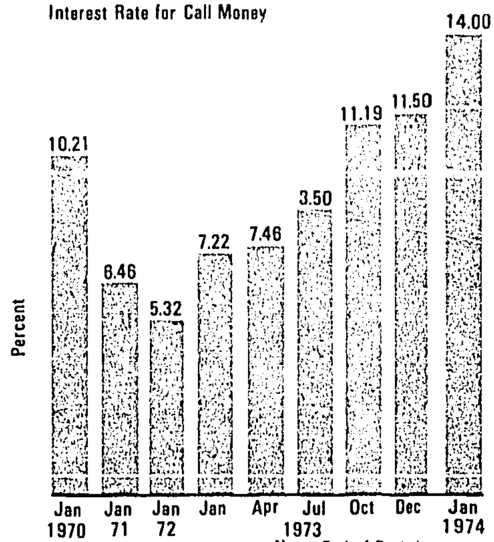
MONEY SUPPLY*



*Seasonally Adjusted

MONEY MARKET RATES

Interest Rate for Call Money



Note: End of Period

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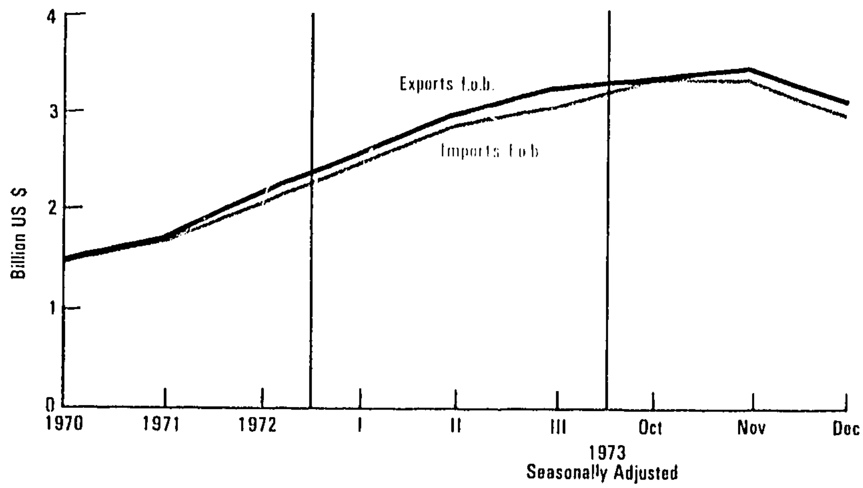
FRANCE: EXTERNAL ECONOMIC INDICATORS

VALUE OF TRADE

Monthly Average



TRADE BALANCE

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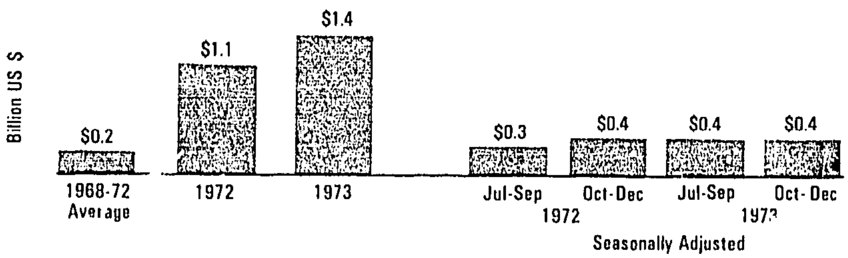
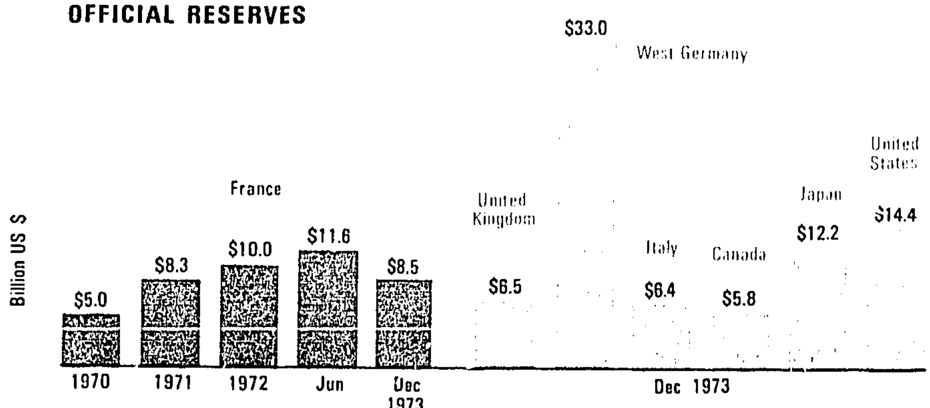


OFFICIAL RESERVES



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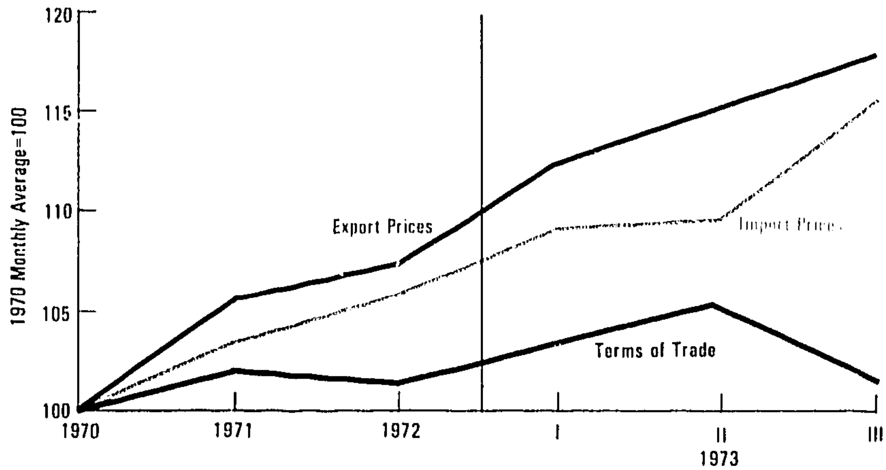
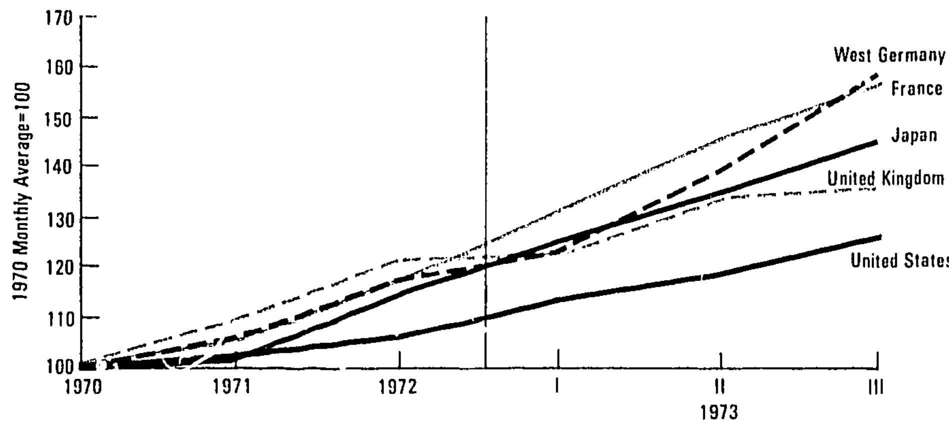
FRANCE: EXTERNAL ECONOMIC INDICATORS

TERMS OF TRADE

National Currency

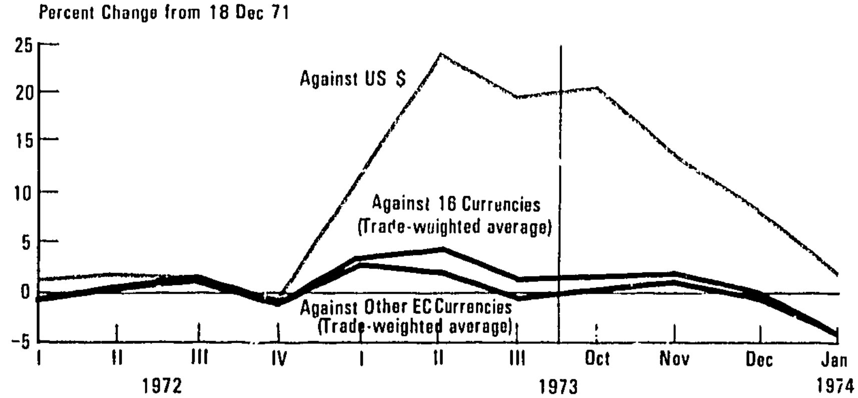


EXPORT PRICES IN US $



EXCHANGE RATES FOR THE FRANC

Percent Change from 18 Dec 71



Note: End of Period

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